

Decision _____

BEFORE THE PUBLIC UTILITIES COMMISSION OF THE STATE OF CALIFORNIA

Application of Southern California Edison Company (U 338 E) for Order Approving Settlement Agreement Between Southern California Edison Company and CNC/SEGS, Inc.; Sithe Energies, Inc.; Exelon SHC, Inc.; GKJ Solar III; UCC-1986 LUZ Solar III; and LUZ Solar Partners, Ltd., III

Application 04-08-004
(Filed August 3, 2004)

OPINION APPROVING SETTLEMENT

Southern California Edison Company (SCE) (U 338 E) requests *ex parte* approval of a Federal Energy Regulatory Commission (FERC) Settlement Agreement dated July 14, 2004 (Agreement) resolving a dispute before the FERC involving the qualifying facility (QF) status of the Solar Electric Generating System (SEGS) III facility (QFID 5017) located at Kramer Junction, California. SCE purchases power from the SEGS III facility under a long-term power purchase agreement dated April 17, 1985, as amended (PPA). The SEGS III facility is a renewable energy resource for purposes of the California Renewables Portfolio Standard Program (RPS).¹

The Agreement is between SCE, on the one hand, and several entities with direct or indirect ownership interests in the SEGS III facility on the other: CNC/SEGS, Inc.; Sithe Energies; Inc.; Exelon SHC, Inc.; GKJ Solar III; UCC-1986

¹ See Pub. Util. Code §§ 399.11 *et seq.*

LUZ Solar III; and LUZ Solar Partners Ltd., III (collectively, the Parties). The Agreement resolves complex issues in a FERC investigation into whether the SEGS III facility has satisfied FERC's ownership requirements for QF status as a result of an acquisition by an electric utility holding company in December 2000 of an indirect upstream ownership interest in the SEGS III facility and the subsequent change in that ownership.²

The Agreement, which resolves all the issues set for hearing by FERC, is contingent on this Commission's approval.

I. The Parties' Dispute at FERC

A. Background: The SEGS III Facility; the PPA with SCE

The SEGS III facility is a 30 Megawatt (MW) solar-powered electric generating facility which was first certified by FERC as a QF on December 19, 1986 in Docket No. QF86-734-000. *LUZ Solar Partners III, Ltd.*, 37 FERC ¶ 2, 244 (1986). The SEGS III facility began commercial operation in January 1987, and sells all of its output to SCE pursuant to the PPA between SCE and LUZ Engineering Corp. (SEGS III, dated April 17, 1985). The PPA is an "Interim Standard Offer Number 4" (ISO4) contract approved by the Commission for the sale of electrical energy and capacity by QFs under the Public Utility Regulatory Policies Act of 1978 (PURPA), 16 U.S.C. § 824-a-1, *et seq.* (2000). On or about December 1985, SCE consented to an assignment of the PPA from LSP III's predecessor to LSP III.

In the PPA, LSP III's predecessor warranted to SCE that its generating facility "meets the requirements of a QF as of the effective date of this Contract

² FERC has exclusive jurisdiction to make QF status determinations. *Independent Energy Producers Ass'n v. California Public Utilities Commission*, 36 F.3d 848, 854 (9th Cir. 1994).

and continuing through the Contract Term.” The term of the PPA extends until January 26, 2017.

B. FERC’s QF Ownership Requirements Under PURPA

To be a QF, a generating facility must meet PURPA’s threshold definition of either a “small power production facility” or “cogeneration facility.” 16 U.S.C. § 796(17) and (18) (2000). Under the statute and FERC’s regulations, a “small power production facility” is defined to include a facility that is an eligible solar facility. 16 U.S.C. § 796(17) (A) (2000); 18 C.F.R. § 292.203(a) (2004). A small power production facility must meet certain additional criteria as to size, ownership, and fuel use to be a QF. 16 U.S.C. § 796(c) (2000). The dispute resolved by the Agreement involves FERC’s ownership criteria for QFs.

Section 3(17) of the Federal Power Act (FPA), as amended by PURPA, provides that a “qualifying small power production facility” must be “owned by a person not primarily engaged in the generation or sale of electric power (other than electric power solely from cogeneration facilities or small power production facilities).” 16 U.S.C. § 796(17)(C)(ii). FERC’s regulations state that:

[a] small power production facility shall be considered to be owned by a person primarily engaged or sale of electric power, if more than 50 percent of the *equity interest* in the facility is held by an electric utility or utilities, or by an electric utility holding company, or companies, or any combination thereof. If a wholly or partially owned subsidiary of an electric utility or electric utility holding company has an ownership interest of a facility, the subsidiary’s ownership shall be considered as ownership by an electric utility or electric utility holding company.

18 C.F.R. § 292.206(b) (2004) (emphasis added). For an entity to meet the ownership test, the applicant must demonstrate that the control of, and stream of

benefits from, the facility is limited to 50% for electric utility or electric utility holding company interests.

C. Utility Ownership of the SEGS III Facility

1. Ownership of the SEGS III Facility as of 1999

The SEGS III facility is owned by three-co-tenants, LUZ Solar Partners Ltd., III (LSP III), GKJ Solar III (GKJ III) and UCC-1986 LUZ Solar III (UCC III) (collectively the Co-Tenants), who presently have ownership interests of approximately 86.8%, 2.6% and 10.5%, respectively. The managing general partner of LSP III, Kramer Junction Company, is responsible for the day-to-day management and operation of the SEGS III facility.

In August 1998 LSP III filed an application for recertification by FERC of the SEGS III facility in light of changes in the SEGS III facility's ownership structure. The application, which FERC approved, stated that the total utility ownership share in the LSP III facility was 49.0049%. *LUZ Solar Partners Ltd. III*, 86 FERC ¶ 62,064, 64,085-86 (1999). Among the eleven non-utility limited partners were CNC/SEGS, Inc. (CNC/SEGS) and Applied Energy, Inc. (Applied Energy). At the time, CNC/SEGS and Applied Energy were indirect, wholly-owned subsidiaries of Sithe Energies, Inc. (Sithe), which was a non-utility for purposes of PURPA and FERC's PURPA regulations.

2. Exelon's Interest in the SEG III Facility After December 18, 2000

On December 18, 2000, Exelon (Fossil) Holdings, Inc. (Exelon Fossil), then a wholly-owned subsidiary of Exelon Corporation (Exelon), acquired a 49.9% interest in Sithe, thereby acquiring a portion of Sithe's indirect interest in the SEGS III facility. Exelon was and is an electric utility holding company as defined in FERC's PURPA regulations. Although Exelon's acquisition of an interest in Sithe was reported to and approved by FERC, the potential impact of

utility ownership of Sithe of the SEGS III facility's QF status was not examined at that time. This acquisition caused the Sithe subsidiary owners of the SEGS III facility, CNC/SEGS and Applied Energy, to become, in part, "utility interests" for purposes of FERC's ownership regulation and caused the utility ownership in the SEGS III facility to exceed 50% on a nominal basis.

Exelon's indirect interest in the SEGS III facility changed in two respects effective November 25, 2003 (*i.e.*, after the FERC proceeding was set for hearing as described below). First, Exelon's indirect interest in Sithe increased from 49.9% to 50%, and is now held through another indirect subsidiary of Exelon Corporation, Exelon SHC. At the same time, Sithe's entire interest in Applied Energy was transferred to a non-utility entity, unrelated to Exelon (together the December 18, 2000 and the November 25, 2000 transactions are referred to as the Exelon Transactions).

D. Initiation of the FERC Proceeding

1. Information Provided by Sithe to FERC Enforcement Staff in October 2003

Sithe representatives contacted FERC's enforcement staff on October 27, 2003 and stated that they had only recently discovered that the December 18, 2000 Exelon transaction may have affected the QF status of the SEGS III facility.

Following Sithe's non-public disclosure of the potential QF ownership regulation issues to FERC's enforcement staff in late October 2003, Sithe and FERC's enforcement staff entered into a Stipulation and Consent Agreement dated November 18, 2003, agreeing that any possible non-compliance with FERC's QF ownership requirements by the SEGS III facility as a result of Exelon's acquisition of an interest therein was inadvertent. On November 20, 2003, FERC approved the Stipulation and Consent Agreement in

Docket Number IN04-4-000. *Sithe Energies, Inc.*, 105 FERC ¶ 61,240 at page 10 (2003) (Consent Approval Order).

2. FERC's November 20, 2003 Hearing Order

On the day the Consent Approval Order was issued, FERC, on its own motion, also issued an order establishing a hearing proceeding to determine if the SEGS III facility “actually satisfied [FERC’s] ownership requirements for QF status.” FERC’s order explained the potential consequences if either or both of the facilities were to fail to meet the QF ownership criteria as a result of the Exelon Transactions:

The Commission in the past has revoked some of the benefits of QF status in cases involving a failure to comply fully with the requirements for QF status. In those cases, where the failure to comply was not willful, the Commission revoked the QF’s exemption from Section 205 of the FPA and determined that the QF was not entitled to charge QF avoided cost rates during the period it had failed to comply with the requirements for QF status, redetermined the applicable rates, and ordered refunds for the period of non-compliance with the requirements for QF status.

November 20 Hearing Order (Exh. SCE – 4) at ¶¶ 14 – 15.

LSP III was not a party to the FERC proceeding prior to issuance of the hearing order. The November 20 Hearing Order provided the first indication to SCE that the SEGS III facility might not be in compliance with the ownership requirements for QF status.

E. Subsequent FERC Proceedings; Discovery

SCE filed a motion to intervene in the FERC proceeding on December 5, 2003 in which SCE explained that it purchases energy and capacity from LSP III pursuant to a power purchase agreement entered into under regulations implementing PURPA. SCE stated that the PPA provides for energy and

capacity payments at avoided cost, which at many times after December 18, 2000 has exceeded the cost of replacement energy and capacity.

II. Settlement Negotiations

Settlement discussions began among SCE, Sithe, and Exelon initially and later all parties. This resulted in the Agreement which was executed on July 14, 2004, and filed with FERC as part of a settlement package that included a Consent Agreement in which FERC trial staff joined.

III. Settlement Agreement

The Agreement, has the following principal terms:

- **Refund Settlement Payment:** In settlement of SCE's claims for refunds with respect to issues relating to QF ownership compliance of the SEGS III Facility for the period from December 18, 2000 through to the Effective Date (described below), LSP III agrees to pay to SCE the sum of [REDACTED] within 60 days after the Effective Date.
- **Reduction of Utility Interests in SEGS III Facility:** CNC/SEGS, Sithe, and Exelon SHC (the "Sithe/Exelon Entities") commit that, within two years from the Effective Date, they will sell or transfer Exelon's indirect upstream interest in the SEGS III Facility or take other steps to reduce total utility ownership shares in the SEGS III Facility by the amount of the current Exelon nominal indirect ownership interest.
- **PPA:** The Agreement provides that nothing in it modifies the PPA, which shall remain in full force and effect.
- **Releases:** The Agreement provides for a termination of the FERC Proceeding, and for mutual releases of claims based on or arising out of the Exelon Transactions or the FERC proceeding or the activities and/or inactivities of any Party in response thereto.

- **Regulatory Approvals and Effective Date:** The Agreement is subject to approvals of both the FERC and this Commission and may be terminated if timely regulatory approvals are not obtained. The “Effective Date” of the Agreement for purposes of the obligation of the SEGS III Facility owners to make the above [REDACTED] payment and effectuate the agreed-upon reduction of utility ownership in the SEGS III Facility, and for the effectiveness of agreed-upon releases, is the date on which both the FERC and the CPUC have issued final orders, no longer subject to rehearing or appeal, approving the Agreement.

Approval of the Agreement is currently pending before FERC. The Parties request a Commission order be issued approving the Agreement by no later than December 31, 2004. The Agreement provides that any Party may terminate the Agreement and resume litigating if a Commission order approving the Agreement does not issue and become final (that is, no longer subject to rehearing or appeal) by June 30, 2005. Thus, a Commission order by the end of 2004 will allow any rehearings or appeals to be considered prior to the June 30, 2005 date. Expedited review also is requested because, in the event the litigation does resume, the passage of time will increase the risk that witnesses or documents will become unavailable or memories will fade, thus undermining SCE’s ability to pursue claims against the owners of the SEGS III facility.

The Office of Ratepayer Advocates (ORA) has analyzed the settlement and recommends approval. ORA reviewed the application, the settlement agreement and the prepared testimony submitted with the application. In addition, ORA conducted its own discovery and review. ORA focused its review on two elements: the settlement amount and the QF contract.

As an initial litigation position, SCE estimated that ratepayers were entitled to a refund of about \$19 million.³ SCE compared PPA prices to real-time prices in the markets of the California Independent System Operator, for the period after the Exelon transaction on December 18, 2000 through 2003.

ORA has determined that, in the past, FERC has allowed substantial latitude to QFs. Moreover, SCE provided ORA with FERC's Certificate of Uncontested Offer of Partial Settlement which seems to indicate that FERC favors the SEGS III facility. The FERC certificate particularly notes (i) that any non-compliance was not substantial, involving, at most, ownership percentages of 4% over the 50% threshold, and (ii) the fact that Sithe reported the potential violation itself.

Based on the representations of SCE, it appears to ORA that, if the other parties prevail, SCE will be awarded no money at all. In light of FERC precedent and the circumstances of this case, ORA believes that the settlement amount is reasonable. ORA says that the QF facility is a renewable energy provider, thus supporting the California Renewables Portfolio Standard Program, which requires each electrical corporation to procure at least 20% of its total retail electricity sales from eligible renewable energy resources by 2017. In ORA's

³ On June 19, 2001, SCE and LSP III, as seller under the PPA, entered into an "Agreement Addressing Renewable Energy Pricing and Payment Issues," based upon a form agreement approved by the Commission for resolving claims arising from SCE's payment suspension to QFs during the California energy crisis. *See* D.01-06-015 and D.01-07-031. This agreement, among other things, contained a release of all claims under the PPA as between SCE and the SEGS III facility arising on and before the June 19, 2001 execution date. Based upon this release, SCE believed that it probably would not have been able to assert a refund claim against the SEGS III facility arising from any finding of noncompliance with the FERC QF ownership regulation for the period prior to June 20, 2001.

estimation SCE has made several strong litigation arguments, but FERC's history in enforcing ownership regulations makes the assessment of litigation success highly uncertain. In regard to the QF contract, ORA gives weight to the project's renewable production, as well as California's efforts to further renewables, as factors favoring prompt resolution of a contentious subject.

Based on ORA's analysis and our independent review of the application, accompanying exhibits, and the Agreement, we will approve the settlement. We note that much of the information we have reviewed was received under seal in accord with Pub. Util. Code § 583 and General Order (GO) 66-C. The assigned Administrative Law Judge (ALJ) issued a protective order in this proceeding to preserve the confidentiality of the designated portions of the application and Exhibits Nos. SCE-1 and SCE-2 (collectively, Confidential Material), and documents related thereto. Public disclosure of the information which SCE seeks to protect regarding the settlement of the lawsuit would place SCE at a severe disadvantage in negotiating settlements of similar claims with other QFs and thereby impair SCE's ability to obtain the best possible settlements on behalf of its ratepayers, and may cause competitive harm to SCE. In addition, Attachment A to Exhibit SCE-1, an economic analysis prepared by one of the parties to the Agreement, is confidential pursuant to a protective order issued in the FERC proceeding.

We find the settlement satisfies the Commission's criteria for evaluating the reasonableness of settlements. The Agreement resolves the QF status of the SEGS III facility by providing (a) for a substantial cash payment, (b) a commitment by SEGS III facility owners to reduce the level of utility ownership in the SEGS III facility, and (c) preservation of the PPA and the renewable power production associated with it for the PPA's remaining life through January 2017.

IV. Comments on Draft Decision

This is an uncontested matter in which the decision grants the requested relief. Therefore, pursuant to § 311(g)(2) of the Pub. Util. Code, the otherwise applicable 30-day period for public review and comment is being waived.

V. Assignment of Proceeding

Geoffrey F. Brown is the Assigned Commissioner and Robert Barnett is the assigned Administrative Law Judge in this proceeding.

Findings of Fact

1. The Federal Power Act provides that a qualifying small power production facility must be owned by a person not primarily engaged in the generation or sale of electric power (other than electric power solely from cogeneration facilities or small power production facilities). For an entity to meet the ownership test, the applicant must demonstrate that the control of, and stream of benefits from, the facility is limited to 50% for electric utility or electric utility holding company interests.

2. The SEGS III facility is a QF subject to the Federal Power Act.

3. On December 18, 2000, Exelon Fossil, then a wholly-owned subsidiary of Exelon, acquired a 49.9% interest in Sithe, thereby acquiring a portion of Sithe's indirect interest in the SEGS III facility. Exelon was and is an electric utility holding company as defined in FERC's PURPA regulations. This acquisition caused the Sithe subsidiary owners of the SEGS III facility, CNC/SEGS and Applied Energy, to become, in part, "utility interests" for purposes of FERC's ownership regulation and caused the utility ownership in the SEGS III facility to exceed 50% on a nominal basis.

4. FERC, on its own motion, issued an order establishing a hearing proceeding to determine if the SEGS III facility actually satisfied FERC's ownership requirements for QF status.

5. SCE intervened in the FERC proceeding because it purchases energy and capacity provided by SEGS III from LSP III, one of the owners of SEGS III, pursuant to a power purchase agreement which provides for energy and capacity payments at avoided cost, which at many times after December 18, 2000 has exceeded the cost of replacement energy and capacity. SCE sought to recover its excessive avoided cost payments.

6. Settlement discussions began among SCE, Sithe, LSP III, and Exelon. This resulted in the Agreement which was executed on July 24, 2004, and filed with FERC. The Agreement requires the approval of this Commission to become effective.

7. The Agreement provides for a substantial payment to SCE by LSP III in consideration of SCE waiving its claim against SEGS III.

8. The Agreement satisfies this Commission's criteria for evaluating the reasonableness of settlements. It resolves the QF status of the SEGS III facility by providing (a) for a substantial cash payment, (b) a commitment by SEGS III facility owners to reduce the level of utility ownership in the SEGS III facility, and (c) preservation of the PPA and the renewable power production associated with it for the PPA's remaining life through January 2017.

Conclusion of Law

The Agreement is in the public interest and should be approved.

O R D E R

IT IS ORDERED that:

1. The Settlement Agreement dated July 14, 2004 between Southern California Edison Company and CNC/SEGS, Inc.; Sithe Energies, Inc.; Exelon SHC, Inc.; GKJ Solar III; UCC-1986 LUZ Solar III; and LUZ Solar Partners, Ltd., III, is approved.

2. This proceeding is closed.

This order is effective today.

Dated _____, at San Francisco, California.